

Under 86 Ill. Adm. Code 140.501(a), where tangible personal property is located in this State at the time of its transfer (or is subsequently produced in Illinois) as an incident to a sale of service, and is then delivered in Illinois, registered servicemen may not claim the Interstate Commerce exemption from Service Occupation Tax. (This is a GIL).

October 1, 2001

Dear Xxxxx:

This letter is in response to your letter dated August 9, 2001. We are unable to issue a Private Letter Ruling in response to your request. This is because the Department's regulations regarding Private Letter Rulings provide that "[i]f there is case law or there are regulations dispositive of the subject of the request, the Department will decline to issue a letter ruling on the subject." 2 Ill. Adm. Code 1200.110(a)(3)(D). Instead we have issued a General Information Letter. General information letters are designed to provide general information, are not statements of Department policy and are not binding on the Department.

In your letter, you have stated and made inquiry as follows:

We represent AAA. On behalf of AAA, and under appropriate power of attorney, we hereby submit the enclosed Request for Private Letter Ruling (the '**PLR Request**'). Please process the enclosed PLR Request and send all responses or requests for further information to PERSON or me. Thank you in advance for your assistance with this matter.

### **REQUEST FOR PRIVATE LETTER RULING**

In accordance with the Illinois Administrative Code ('**Code**'), the Illinois Department of Revenue ('**IDOR**') will issue Private Letter Rulings ('**PLRs**') in response to specific taxpayer inquiries concerning the application of a tax statute or rule to a particular fact situation. 2 IL ADC 1200.110(a). AAA, an Illinois corporation engaged in design and printing services ('**AAA**'), hereby makes the following PLR request ('**PLR Request**').

#### **I. STATEMENT OF FACTS.**

One of AAA's primary services is designing and printing catalog order forms and inserts ('**Forms**') for both domestic and foreign companies engaged in retail catalog sales ('**Retailers**'). In a typical transaction, AAA contracts directly with a Retailer to design and print the Forms that are inserted in their catalogs. AAA takes these orders and designs and prints the Forms at its offices in CITY, Illinois. Large catalog producers, binderies or fulfillment houses ('**Producers**') print the catalogs. AAA delivers the completed Forms directly to the Producer to be inserted in the catalogs and distributed

nation-wide via United States Mail. These 'typical transactions' occur each tax year and are the basis of this PLR Request.

AAA has been the subject of two recent audits by the IDOR, one in 1997 and another in 2000. On or about January 15, 1997, NAME2, representing the IDOR, completed a Sales and Use Tax Audit of AAA ('**Audit I**'). NAME2 determined that AAA was liable for Sales Tax (defined below) based on the gross receipts attributable to tangible personal property received by AAA from the portion of the Forms that were ultimately distributed in catalogs in Illinois. The Forms that remained in Illinois were estimated at 5%<sup>1</sup> of the total; thus, AAA was liable for Sales Tax based on 5% of the selling price of the property.

On or about March 20, 2000, NAME3, representing the IDOR, completed a Sales and Use Tax Audit of AAA ('**Audit II**'). Apparently, NAME3 believed that Audit I was incorrect, because he determined that AAA was liable for Sales Tax based on the gross receipts received by AAA from all of the Forms sold to Retailers and delivered to Illinois Producers, whether such Forms were ultimately distributed in Illinois or not.

Thus, AAA has received conflicting oral reports from the IDOR with respect to its Sales Tax liability on one of its primary services. Taxpayers cannot rely on verbal opinions from IDOR employees, but will be protected only if the opinion from the IDOR is in writing. 86 IL ADC 140.901(a). These conflicting audit results create uncertainty regarding AAA's Sales Tax liability. Thus, in order to comply with Illinois' Sales Tax, AAA has submitted this PLR Request.

The conclusions set forth in Audit II present severe disadvantages to AAA and other similarly situated Illinois printers who must compete with out-of-state printers. Because out-of-state printers are not subject to the same Sales Tax (see discussion below), there is a substantial incentive for Illinois Retailers to contract with printers who do not have to add Illinois Sales Tax to their price. The material content in AAA's typical job is 45% of the total value of the job and the Sales Tax rate in Illinois is 6.25%. Thus, the effective Sales Tax rate on any sale by AAA is 2.8125% ( $45\% \times 6.25\%$ ). This effectively gives all Retailers utilizing Illinois Producers an incentive to contract with printers who do not have to add Sales Tax to their price.

In this PLR Request, AAA is merely seeking a level playing field, for itself and other similarly situated Illinois residents. Past amendments to the Illinois Sales Tax have been passed to promote equality between residents of different States. That is all that AAA seeks, equality. Illinois' public policy should not be to penalize its own residents in favor of out-of- state interests.

## **II. ARGUMENTS.**

### **A. Application of the Sales Tax.**

In Illinois, the term '**Sales Tax**' includes taxes imposed under the Use Tax Act (35 ILCS 105/1 et seq., the '**Use Tax**'), the Retailer's Occupation Tax Act (35 ILCS 120/1 et seq., the '**Retailer's Occupation Tax**'), the Service Use Tax Act (35 ILCS 110/1 et seq., the '**Service Use Tax**') and the Service Occupation Tax Act (35 ILCS 115/1 et seq., the '**Service Occupation Tax**'). The Use Tax imposes a tax on the privilege of using tangible personal property in Illinois purchased at retail. 35 ILCS 105/3. The Retailer's

Occupation Tax imposes a tax on persons engaged in the business of selling tangible personal property at retail. 35 ILCS 120/2. The Use Tax and the Retailer's Occupation Tax focus on parties engaged in retail sales of tangible personal property. As a designer and printer, AAA provides services to its customers and the transfer of tangible personal property (e.g., the Forms) is merely incidental to such services. Therefore, the Use Tax and the Retailer's Occupation Tax are not applicable to AAA in a typical transaction.

The Service Use Tax imposes a tax on the privilege of using tangible personal property in Illinois acquired as an incident to the purchase of a service from a Serviceman (defined below). 35 ILCS 110/3. The Service Occupation Tax imposes a tax on persons engaged in the business of making sales of service (referred to as '**Servicemen**') on all tangible personal property transferred as an incident of a sale of service. 35 ILCS 115/3. The Service Use Tax and the Service Occupation Tax focus on parties engaged in sales of a service where tangible personal property is transferred incidental to such services. AAA provides a service to its customers and the transfer of personal property is incident to such services. Therefore, both the Service Use Tax and the Service Occupation Tax are relevant to AAA's typical transactions.

The transfer of tangible personal property from AAA to a Retailer is a taxable event, which creates a Service Occupation Tax liability for AAA. Further, the use of such property by a Retailer is a taxable event, which creates a Service Use Tax liability for the Retailer. This seems to result in a double-recovery windfall for the IDOR. However, the IDOR cannot collect tax on the same transaction from both the seller and the purchaser. Cottage Hill Operating Co. v. IDOR, 481 N.E.2d 309 (Ill. App. 2nd Dist. 1985). The Service Use Tax and the Service Occupation Tax are complementary to one another and will not be collected from both sides of a single transaction.

## **B. Interstate Commerce Exemption.**

An exemption exists that avoids all liability under the Service Occupation Tax for Forms shipped outside of Illinois. A Serviceman does not incur Service Occupation Tax liability on property sold as an incident to a sale of service under an agreement by which the Serviceman is obligated to make physical delivery of the goods from a point in Illinois to a point outside of Illinois. 86 IL ADC 140.501(b). To qualify for this exemption, the property must not be returned to Illinois and the shipment contemplated must actually occur. Id. Such delivery may be made by the Serviceman, by carrier or through the mail. Id. Sales of service of this type are deemed to be within the protection of the Commerce Clause of the Constitution of the United States. Id.

Except for a small portion of the Forms distributed in Illinois, estimated at 5% by NAME2, AAA contracts directly with Retailers to ship the Forms to Producers to be distributed outside of Illinois. The Forms are sent nation-wide through the United States Mail without the Retailer ever coming into physical possession of the Forms. While it is true that the Forms are first shipped to a Producer in Illinois to be included in catalogs, this additional stop is temporary and should be disregarded for purposes of the Service Occupation Tax. The economic reality is that AAA is shipping its products out-of-state, except for that small portion that is ultimately distributed within Illinois.<sup>2</sup> It just so happens that the Forms, on their way out-of-state, are momentarily routed through an Illinois distribution point. Indeed, if AAA itself provided the incidental service provided by the Producers, there would be no Service Occupation Tax liability for AAA. This is the conclusion reached in Audit I, and it is correct.

Nor is this conclusion changed by Deere & Co. v. Allphin, 346 N.E. 2d 117 (Ill. App. 3d Dist. 1977). In that case, the plaintiffs, a retailer and a printer, both located in Illinois, brought suit against the director of the IDOR claiming that they were not liable for Sales Tax. Id. The Deere court ultimately held that the parties were liable for Sales Tax. Id. However, Deere is distinguishable from AAA's typical transaction and does not address the Equal Protection issues discussed below in Section C.

The Deere court held that the Service Occupation Tax exemption discussed above did not apply to the plaintiffs for two reasons. First, the Deere court noted that the exception only applies to products that are sold. Id. According to the court, since the plaintiff there was distributing marketing materials for no charge, the transaction was more in the nature of a gift than a sale. Id. That is not the case here. Here, AAA performs design and printing services, for which it is paid. That satisfies the 'sale' requirement of the exemption: 'serviceman does not incur Service Occupation Tax liability on property which he resells as an incident to a sale of service...' 86 IL ADC 140.501(b).

Second, the Deere court held that the exception did not apply because some of the property sent out-of-state by the plaintiff (order forms and coupons) was meant to return to Illinois once customers redeemed coupons and placed orders. See Deere. That is not the case here. The exception, as it currently exists at 86 IL ADC 140.501(b), does not require that **all** of the property transferred in a particular transaction not be returned. The exemption merely requires that the out-of-state shipment must actually occur and the property not subject to the tax must not be returned to Illinois. Id. Any attempt to impose a requirement that no product be returned would be meaningless, as it is easy to create different orders for property sent out-of-state and another for the portion ultimately returned. AAA is not seeking an exemption for all of the property transferred in their typical transactions, only the portion that ultimately is shipped outside of Illinois and not returned.

### **C. Equal Protection.**

The Equal Protection Clause of the Constitution of the State of Illinois states that no person shall be denied equal protection of the laws. Ill. Const. Art. I, Sec. 2. The Equal Protection Clause guarantees that those similarly situated will be dealt with in a similar manner. East St. Louis Fed. of Teachers, Local 1220 v. East St. Louis Sch. Dist. No.189, 687 N.E.2d 1050 (Ill. 1997). Illinois' Sales Tax treats similarly situated taxpayers in a substantially different manner. The flat taxes imposed by the Sales Tax discriminate **against** Illinois residents in favor of nonresidents.

If the exemption discussed in Section B above does not apply to AAA, then AAA, with a clear nexus to Illinois, is liable for the Service Occupation Tax. A printer from another state, however, with no other nexus to Illinois, would not be liable for the Service Occupation Tax even if it sent its products to Producers in Illinois like AAA does. This is because Illinois would have no authority to tax such an entity. Such sales would also be exempt from the Service Use Tax due to their 'temporary use' in Illinois. 86 IL ADC 160.110. No Service Use Tax is imposed on a use in Illinois of property acquired outside of Illinois that is temporarily brought to Illinois to be physically attached or incorporated into other property that is ultimately used outside of Illinois. Id. This creates a substantial incentive for Illinois Retailers to contract with printers outside of Illinois.

The sale price could be decreased by the effective amount of the Sales Tax, in AAA's case that would be 2.8125% of the total sales price.

Similarly, when the Retailers contract directly with a Producer to design and print the catalogs and the Forms, no Service Occupation Tax is paid on the value of the catalogs and Forms sent outside of Illinois. This transaction falls into the exemption discussed above in Section B.

### **III. STATEMENT REGARDING PRIOR IDOR RULINGS.**

To the best knowledge of both AAA and AAA's representative, the IDOR has not previously ruled on the same or similar issue for AAA or a predecessor and no request for such advice has been made and withdrawn.

### **IV. STATEMENT REGARDING PENDING AUDITS AND LITIGATION.**

To the best knowledge of both AAA and AAA's representative, no audit or litigation is currently pending with the IDOR.

### **V. IDENTIFICATION OF TRADE SECRET INFORMATION.**

There is no trade secret information that should be deleted from the publicly disseminated version of this PLR, except for the name and address of AAA and AAA's representative.

Submitted on August 1, 2001 by FIRM, an Illinois corporation, on behalf of AAA, under appropriate power of attorney attached hereto.

Special order printing is generally subject to the Service Occupation Tax Act. Under the Service Occupation Tax Act, servicemen are taxed on tangible personal property transferred incident to sales of service.

The purchase of tangible personal property that is transferred to service customers may result in either Service Occupation Tax liability or Use Tax liability for the servicemen, depending upon which tax base the servicemen choose to calculate their liability. Servicemen may calculate their tax base in one of four ways: (1) separately stated selling price; (2) 50% of the entire bill; (3) Service Occupation Tax on cost price if they are registered de minimis servicemen; or, (4) Use Tax on cost price if the servicemen are de minimis and are not otherwise required to be registered under Section 2a of the Retailers' Occupation Tax Act.

Using the first method, servicemen may separately state the selling price of each item transferred as a result of sales of service. The tax is based on the separately stated selling price of the tangible personal property transferred.

Under a second method, if servicemen do not wish to separately state the selling price of the tangible personal property transferred, those servicemen must use 50% of the entire bill to their service customers as the tax base. Both of the above methods provide that in no event may the tax base be less than the cost price of the tangible personal property transferred. Under these methods, servicemen may provide their suppliers with Certificates of Resale when purchasing the tangible personal property to be transferred as a part of the sales of service.

The third way servicemen may account for their tax liability only applies to de minimis servicemen who have either chosen to be registered or are required to be registered because they incur Retailers' Occupation Tax liability with respect to a portion of their business. Servicemen may qualify as de minimis if they determine that their annual aggregate cost price of tangible personal property transferred incident to sales of service is less than 35% of their annual gross receipts from service transactions (75% in the case of pharmacists and persons engaged in graphic arts production). See 86 Ill. Adm. Code 140.101. This class of registered de minimis servicemen is authorized to pay Service Occupation Tax (which includes local taxes) based upon the cost price of tangible personal property transferred incident to sales of service. They remit the tax to the Department by filing returns and do not pay tax to suppliers. They provide suppliers with Certificates of Resale for the property transferred to service customers.

The final method of determining tax liability may be used by de minimis servicemen that are not otherwise required to be registered under the Retailers' Occupation Tax Act. Servicemen may qualify as de minimis if they determine that their annual aggregate cost price of tangible personal property transferred incident to sales of service is less than 35% of their annual gross receipts from service transactions (75% in the case of pharmacists and persons engaged in graphic arts production). Such de minimis servicemen may pay Use Tax to their suppliers or may self-assess and remit Use Tax to the Department when making purchases from unregistered out-of-State suppliers. Those servicemen are not authorized to collect "tax" from their service customers, nor are they liable for Service Occupation Tax.

Generally, printers and mailing houses handle their liabilities under one of the de minimis methods. Printers that are registered under the Service Occupation Tax Act may claim the interstate commerce exemption for those materials shipped out of Illinois. Under the interstate commerce exemption, servicemen do not incur Service Occupation Tax liability on property that they resell as an incident to a sale of service under an agreement by which they are obligated to make physical delivery of the goods from a point in Illinois to a point outside Illinois, not to be returned to a point within Illinois, provided that such delivery is actually made. See 86 Ill. Adm. Code 140.501(b).

However, please note that 86 Ill. Adm. Code 140.501(a) provides that "[w]here tangible personal property is located in this State at the time of its transfer (or is subsequently produced in Illinois) as an incident to a sale of service, and is then delivered in Illinois, the serviceman incurs Service Occupation Tax liability on the selling price of the property. The sale is not deemed to be in interstate commerce if the purchaser or his representative receives the physical possession of such property in this State. This is so notwithstanding the fact that the purchaser may, after receiving physical possession of the property in this State, transport or send the property out of the State for use outside the State or for use in the conduct of interstate commerce."

We do not know what method your client uses to calculate its Service Occupation Tax. However, as you can see under 140.501(a), if a registered serviceman makes deliveries of tangible personal property in Illinois, either to the purchaser or to its representative, the Interstate Commerce exemption from sales tax is not available. This is the case whether the purchaser or his representative will transport or send the property out of Illinois for use. The Department does not have the authority to rule that this temporary stop should be disregarded for purposes of the Service Occupation Tax.

I hope this information is helpful. The Department of Revenue maintains a Web site, which can be accessed at [www.revenue.state.il.us](http://www.revenue.state.il.us). If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

Very truly yours,

Martha P. Mote  
Associate Counsel

MPM:msk  
Enc.

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<sup>1</sup> The 5% figured used by NAME2 is derived from 1990 United States Census figures representing the population of Illinois compared to the population of the United State.

<sup>2</sup> Presumably, the current percentage of Forms deemed to be distributed in Illinois should relate to available 2000 United States Census figures representing the population of Illinois compared to the population of the United States.